Supreme Court, U.S.
FILED
SEP 10 1992
OFFICE OF THE CLERK

No. 92-83

In The

Supreme Court of the United States

October Term, 1992

JOHN D. TURNER

Petitioner,

v.

FINANCIAL CORPORATION OF AMERICA, et al.,

Respondents.

On Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

REPLY BRIEF FOR PETITIONER TO RESPONDENTS' JOINT BRIEF IN OPPOSITION

JOHN D. TURNER
Petitioner
5405 Prospect Road No. 1,
San Jose, California 95129-4846
(408) 446-9888

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342 2831

TABLE OF CONTENTS

Page

TABLE OF CONTENTS i

TABLE OF AUTHORITIES ii

SUMMARY OF THE ARGUMENT 1

ANSWER TO RESPONDENTS' REASONS FOR DENYING THE PETITION 1

1. The In Re Apple Computer Securities Litigation Argument..... 1

2. The Ninth Circuit Did Not Properly Apply the Standard For Summary Judgment..... 3

3. Answer to Respondents Assertion that The Ninth Circuit Properly Applied the Standard For Summary Judgment relying on the *In re Apple* proposition that a plaintiff must prove "materiality and reliance" to prevail on a 10b-5 claim..... 3

4. Respondents Claim the Ninth Circuit Properly Identified Petitioner Turner's Primary Claims Concerning Misrepresentation and Omission as Popejoy Being Overly Optimistic about American; and that FCA Failed to Disclose the Inadequacy of the Loan Loss Reserves for American..... 5

5. Respondents Claim The Ninth Circuit found that the risky nature of FCA Stock well disclosed in its 10-K filings and in the media..... 6

6. Respondents Confuse Turner's Fraud On the Market Argument..... 9

7. The Ninth Circuit Erred by Ruling That Turner Could Not Establish the Reliance Element of His Securities Fraud Claim Where the Undisputed Facts Showed that Turner Performed His Own Financial Analysis, Followed The Stock Closely, and Knew of FCA's Financial Problems..... 10

CONCLUSION 10

TABLE OF AUTHORITIES

Page

In re Apple Computer Securities Litigation, 866 F.2d 1109 ..... 1, 3, 4, 5

Basic, Inc. v. Levinson, 485 U.S. 224 (1988).....1, 10

Greenfield v. Heublein, Inc., 742 F.2d 751, 758 (3d Cir. 1984), cert. denied, ___ U.S. ___ 105 S.Ct. 1189 (1985)..... 2

Securities and Exchange Commission v. Texas Gulf Sulphur Co., 401 F.2d 833, 861-2 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969)..... 2

First Virginia Bankshares v. Benson, 559 F.2d 1307, 1317 (5th Cir. 1977), cert. denied 435 U.S. 952 (1978)..... 2

Virginia Bankshares, Inc. v. Sandberg, ___ U.S. ___, 111 S.Ct. 2749 (1991) 10

SUMMARY OF ARGUMENT

The Ninth Circuit rubber-stamped the District Court's incorrect arbitrary identification of Turner's primary complaint as Popejoy's optimistic statements and FCA's failure to have sufficient reserves for losses.

These are only subsets of their 10b-5 violations. They omitted material facts and filed materially misleading statements with the SEC about the condition of their loan receivable assets. They also withheld that they were in receipt of secret indemnification agreements issued by the Federal Home Loan Bank Board. Turner relied on information published or omitted by FCA in their 10-K's, 10-Q's, and their official press releases. Popejoy's statements were a part of that total mix.

The Ninth Circuit decision in this case fails to embody this court's principals and their standard would grant a license to violate securities reporting requirements by filing false and misleading SEC reports with immunity to securities law as long as there is enough controversy about a company published in the media.

Basic, Inc. v. Levinson, 485 U.S. 224 (1988) and *In re Apple Computer Securities Litigation,* 866 F.2d at 1109, are class action cases. Their standards and principals ill fit the facts of an individual trading in the market relying upon 10-K, 10-Q and official company press releases to make his investment decisions.

In developing their erroneous legal concept of materiality and omissions in this case the Ninth Circuit wrongly applied these class action principals.

Turner made his investment decisions relying upon FCA's reported information and their omissions, in SEC required format, which Congress intended that he be legally entitled to rely upon.

ANSWER TO RESPONDENTS' REASONS FOR DENYING THE PETITION ARGUMENT

1. The In Re Apple Computer Securities Litigation Argument.

In *Apple* the dispute centered around a product which had received quality control, premarket testing, etc. Further the

officers all filed affidavits of their good faith belief in the statements they made about the product.

In striking contrast in this case the FCA officers and directors were informed from the fourth quarter of 1984 through November of 1985 as to the improvident nature of their product, that a significant portion of their assets had been generated in a general course of fraud and none of the respondents, including spokesman Popejoy, filed affidavits of their good faith and belief in the statements they made or approved in company press releases, and 10-Q and 10-K statements.

They also withheld from Petitioner that they had received indemnification agreements issued by FHLBB Resolutions to reimburse them for any financial losses suffered as directors and officers of FCA/American. (App. 163a-176a; 198a)

Under Popejoy's management, FCA spoke out steadily about their exhaustive task force investigation of their loan portfolio assets and the reasons for loan loss provision increases.

While an affirmative duty to disclose exists only in limited circumstances, once an affirmative disclosure is voluntarily made, a duty arises to tell the entire truth about the subject of the disclosure. If a corporation chooses to speak voluntarily, its statements must be truthful and complete in all material respects. A standard this court has clearly upheld in *Greenfield v. Heublein, Inc.*, 742 F.2d 751, 758 (3d Cir. 1984), cert. denied, ___ U.S. ___ 105 S. Ct. 1189 (1985); *Securities and Exchange Commission v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 861-2 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969). Or as another court stated more simply, "[A] duty to speak the full truth arises when a defendant undertakes to say anything." *First Virginia Bankshares v. Benson*, 559 F.2d 1307, 1317 (5th Cir. 1977), cert. denied 435 U.S. 952 (1978).

FCA was secretly insolvent when Popejoy took over in September 1984. FCA's loan portfolio of "improvident loans" caused the company to be insolvent at all times. After their discovery (between the fourth quarter of 1984 through November 1985), by the new Popejoy management, FCA was

required to report this material fact. Any press speculations about the risky nature of FCA having a portfolio with a high number of fixed rate loans or loans in economically troubled oil patch states certainly is not credible evidence of FCA's true loan portfolio problems. (App. 92a-142a)

2. The Ninth Circuit Did Not Properly Apply the Standard For Summary Judgment.

The Ninth Circuit's *de novo* review was severely deficit as shown in Petitioner Turner's "Petition for Rehearing" (App. 54a-74a). Rehearing was denied – but in a split vote. (App. 22a)

3. Answer to Respondents Assertion that The Ninth Circuit Properly Applied the Standard For Summary Judgment relying on the *In re Apple* proposition that a plaintiff must prove "materiality and reliance" to prevail on a 10b-5 claim.

The Ninth Circuit arrived at its conclusions regarding "materiality" and "reliance" based upon holding Turner constructively on notice of the content of media stories. These publications submitted by respondents comprised soft information which could reasonably be interpreted differently than the lower court's interpretation. So that there was more than "one reasonable conclusion". And clearly a far different set of facts than those contained in *In re Apple Litigation.*

Applying the standard the Ninth Circuit held *In Re Apple Computer Securities Litigation,* 886 F.2d at 1114:

> "Ordinarily, omissions by corporate insiders are not rendered immaterial by the fact that the omitted facts are otherwise available to the public. [citations omitted]. Where a plaintiff alleges actual reliance on a particular statement, it does not matter that the market is aware of the facts necessary to make the statement not misleading. The plaintiff may be misled into believing that the stock has been incorrectly valued by the market."

Also the Ninth Circuit held in *In Re Apple Securities Litigation* (at 1116, [7]):

> "Even in a fraud on the market case, corporate insiders are not relieved of their duty to disclose material information where that information has received only brief mention in a few poorly-circulated or lightly-regarded publications. The investing public justifiably places heavy reliance on the statements and opinions of corporate insiders. In order to avoid Rule 10b-5 liability, any material information which insiders fail to disclose must be transmitted to the public with a degree of intensity and credibility sufficient to effectively counterbalance any misleading impression created by insiders' one-sided representations."

That standard has not been met in this case because the press was unaware of the existence of the fraud outlined in the proof of loss, the improvident loans it generated, or their extent and condition.

The dramatic rise in FCA's stock prices to $17.25 over the next 16 months after Knapp resigned and Popejoy took over provide a strong indication that FCA's new management was making statements that were material in that the stock price quadrupled. And as the Ninth Circuit held in *In Re Apple Securities Litigation*, at 1116 [8], even in a fraud upon the market class action case:

> "An entirely plausible explanation would be that the market was persuaded by Apple's optimism notwithstanding the known risks. In that case, the optimistic statement could still result in liability if the statement was not genuinely believed, or if that belief lacked a reasonable basis."

One could easily replace the name "Apple's" with "FCA's" in the above statement of the Ninth Circuit Court.

Then when weighed by the information contained in: 1) The "Proof Of Loss" (App. 163a); 2) The "Indemnification Agreements between the Directors and the FHLBB" (App. 198a); 3) The sworn testimony of M. Danny Wall before the House Banking Committee (App. 195a-197a); 4) The Peer Review report of the SF-FHLB. (App. 191a-194a)

The question of fact for a jury immediately becomes whether there was any reasonable basis for their optimistic statements about FCA's recovery. And whether genuinely believed by them when they were made.

So the class action standards used by the courts below to rationalize away the materiality to Turner of an undisclosed portfolio of fraudulently generated improvident loans and assets, (created as a normal course of business), are not standards supported in *In re Apple* as they claim.

4. Respondents Claim the Ninth Circuit Properly Identified Petitioner Turner's Primary Claims Concerning Misrepresentation and Omission as Popejoy Being Overly Optimistic about American; and that FCA Failed to Disclose the Inadequacy of the Loan Loss Reserves for American.

This is patently false. Turner's primary claim is that Respondents Popejoy, and the officer/director defendants:

1). Discovered, and did not disclose, more than a year before Turner began to purchase (during the period between the fourth quarter of 1984 and November, 1985) that FCA's assets were generated through a general practice of fraud, were improvident, and not only likely to cause the company continuing losses, but were in fact causing continuing losses. Rather than report this material information to the shareholders, the SEC and the market, they sought and received indemnification by the FHLBB for any losses they might sustain by serving as officers and directors of FCA/American. (App. 163a-176a; App. 198a)

2). The FHLBB passed at least one resolution granting indemnification, and there is evidence that prior to the 1988 shareholders' meeting others may have been passed. (App. 198a)

So rather than service as loyal fiduciaries to the shareholders the respondents served as fiduciaries with divided loyalties which were not reported to petitioner so that he could be on guard against their statements about the financial condition of the company.

These hard facts were material information that any reasonable speculator or investor would need in order to make an informed investment decision about whether FCA/American was

indeed recovering, or could recover, as Popejoy claimed; had the assets of $320 million it reported in its second quarter 10-Q as late as June 30th, 1987, or in fact had a negative net worth and was expected to cost the FSLIC $4 billion dollars as stated in the SF-FHLB files.

The test respondents claim the Ninth Circuit faithfully applied was no test of the correct claim and position of Turner at all. And even the wrong test applied to the wrong proposition wrongly held Turner constructively on notice of "a morass of contrary information" which was allegedly reported in publications Turner did not even read, were published in many instances before he even began to invest, and most certainly were comprised of soft information subject to more than one reasonable conclusion.

The Ninth Circuit Panel errs when considering and weighing the total mix of publicly available information, including media stories identifying the speculative nature of FCA stock.

5. Respondents Claim The Ninth Circuit found that the risky nature of FCA Stock well disclosed in its 10-K filings and in the media.

Every stock has a speculative nature of some degree. That FCA stock had a speculative nature is not a defense to securities fraud. That FCA was risky is not the point at all. The question is whether every material risk was disclosed.

The degree of risk, whether 1% or 99% does not grant a license under securities law, or excuse respondents from reporting the material facts they discovered. Especially when they spoke out quarterly giving other reasons for losses they were setting aside the loan loss reserves to cover.

This "risky nature" non-argument certainly does not grant respondents the right to withhold hard material facts that would have warned any reasonable person that FCA's assets were phantom assets generated through a general practice of fraud, or that its directors and officers had divided loyalties between the shareholders, the Savings and Loan Industry and the FHLBB.

The facts of this case make it clear that the FHLBB did not want the market or the investor to know the true financial condition of FCA or its subsidiary S&L American Savings.

Petitioner presented probative evidence of a motive, opportunity and a history of the same kinds of violations of securities law by the FHLBB while it incompetently attempted to deal with the fraud and abuse they were discovering within the industry they were obligated to regulate. (App. 229a-234a)

With respect to Respondents' claim that the Ninth Circuit properly found that reporting provisions for loan loss of $422 million in 1984 (two years before Turner's first purchase) and $182 million in 1985 adequately disclosed the discoveries set forth in the proof of loss, or at least the financial impact of the proof of loss disclosures.

Not all of the Ninth Circuit Panel agreed as Judge Noonan (JN) pointed out in this oral argument interchange. Attorney Peter Thurston (PT) argued as proof of detailed disclosure that the 1985 10-K disclosed FCA had to restate its income in 1984 from a gain of $75 million to a loss of $75 million.

JN: Mr. Thurston I'm looking at Judge Patel's Opinion in which she says that the details of the Knapp management misdeeds were well documented in various financial periodicals as well as in FCA's 10-K report. Now were they well documented in the 10-K report?

PT: Yes! I don' think . . .

JN: Would you point to that please?

PT: Yes! the 10-K report noted that in 1984 . . .

JN: Which 10-K is this?

PT: This is the December 31, 1985 10-K tells you that in 1984 they went from a stated profit in July of a positive $74 million to being seized by the FHLBB and to restating their loans to a $75 million dollar loss. Now I don't think that a rational reasonable investor knowing this Mr. Turner was fully conversant with this he knew that Mr.

Knapp had been ousted he knew that they had to restate their earnings from a $75 million profit to a $75 million dollar loss a $150 million dollar swing in less than six months he knew that and for him to say but I had no notion that Knapp or those people who had those kinds of loans were doing anything untoward that they were making improvident loans.

JN: Well it certainly reflects a change in the balance sheet but does that 10-K say financial misdeeds he was fraudulent here he was fraudulent there.

PT: The 10-K states that Mr. Knapp and his officers and directors were removed and replaced by were replaced by Mr. Popejoy in September of 1984 by the FHLBB.

JN: For Fraud?

PT: They didn't say fraud. I don't think there was any indication there was fraud.

JN: No I'm talking about Judge Patel somehow finding a detailed statement of financial misdeeds.

PT: Sir but the difficulty I'm having is that your characterizing the conduct of the Knapp people as fraudulent.

JN: No I just wanted to see how sound her opinion was and she says there was a well documented detailed statement of financial misdeeds in the 10-K. Now you haven't told me about that!

PT: I've told you historically what happened . . .

JN: You've told me there was a shift in the balance.

PT: I've told you that there was a restatement of a 150 million dollars and a removal of the FHLBB management.

JN: But is that a detailed statement of financial misdeeds?

PT: I don't . . . I think it gives you a pretty good indication of what was going on I think that anyone who ignores that is saying that I'm going to lose my eyes and go ahead . . .

> JN: I don't know why you think that because many banks as well as savings and loans made bets on real estate that turned sour and had to restate their profits. Its very different in making a mistake as to what the financial condition of the area will be to doing something fraudulent.

Having loans in the Texas Oil Patch, Rust Belt, and other States where economic conditions went sour, and a large number of fixed rate loans, was the 10-K risk disclosed in April 1986 when Petitioner began to purchase FCA common. A far different risk from disclosing that there was a whole course of fraudulent lending practices which caused the company to have a significant number of phantom assets being carried upon their books as though they were real assets.

Also in this interchange Respondents' attorney made several incorrect statements. The 1985 10-K stated that FCA's 1984 restatement of earnings was due to a SEC forced restatement of FCA's reported income derived from "Dollar Roll Reversal" transactions. Which was counting income derived from successful trading in mortgage backed securities while deferring losses incurred by poorly timed trades. Nothing at all to do with FCA or American's fraudulently generating assets and its real estate loan portfolio.

Furthermore neither 1985 10-K nor any following 10-Q or 10-K, nor any FCA Press Release, states, infers or reveals, that the FHLBB removed the Knapp Management.

6. Respondents Confuse Turner's Fraud On the Market Argument.

Turner does allege that there was a fraud upon the market in his complaint as well as a fraud upon him, as an investor relying upon the company's 10-K, 10-Q and Official Press Releases. He shows, in his petition to this court, by the logic behind the fraud upon the market theory that the evidence supports that the market was also misled by FCA's 10-K and 10-Q reports and their steady stream of press releases.

Their ad hominem attacks require an isolated investor. The logic behind the legally established Fraud on the Market

Theory makes it difficult to isolate Turner from the comparable actions and decisions of other investors and the market's action.

7. The Ninth Circuit Erred by Ruling That Turner Could Not Establish the Reliance Element of His Securities Fraud Claim Where the Undisputed Facts Showed that Turner Performed His Own Financial Analysis, Followed The Stock Closely, and Knew of FCA's Financial Problems.

First) The facts clearly show that neither Turner (nor the market) knew of FCA's true financial problems.

Second) Petitioner Turner used a calculator to add/subtract/multiply and divide numbers provided him in a 10-K or 10-Q form. He used a modern math program called Lotus 123 (which is a general software spreadsheet adaptable to may forms of math functions) and a computer to do the calculation.

Surely he is not then prohibited from bringing an action if the information he relied on about FCA's assets (which in turn led him to believe there was a recovery in place and to evaluate the branches when FCA met its recovery target) omitted and was missing material facts.

The Ninth Circuit improperly applied this Courts standards set in *Basic, Inc., supra* and *Virginia Bankshares, Inc.*, and in their own decision in *In re Apple Securities Litigation, supra* – establishing legal principals which make bad law with disastrous financial consequences to an investor seeking protection guaranteed him by Acts of Congress.

CONCLUSION

For these foregoing reasons Turner's petition should be granted.

Respectfully submitted,

JOHN D. TURNER
Petitioner

DATED: September 10, 1992